



Government Gazette Staatskoerant

REPUBLIC OF SOUTH AFRICA
REPUBLIEK VAN SUID-AFRIKA

Vol. 468

Pretoria, 23 June 2004
Junie

No. 26493



9771682584003



AIDS HELPLINE: 0800-0123-22 Prevention is the cure

CONTENTS • INHOUD

No.

*Page
No. Gazette
 No.*

GENERAL NOTICE

Trade and Industry, Department of

General Notice

1183	South African Company Law for the 21st Century: Guidelines for Corporate Law Reform: For public comments	3	26493
------	--	---	-------

GENERAL NOTICE

NOTICE 1183 OF 2004

South African Company Law for the 21st Century

Guidelines for Corporate Law Reform

May 2004

CONFIDENTIAL

The dti wishes to express its appreciation to all South African and international experts who have contributed to the formulation of this policy document. In particular, the dti wishes to acknowledge the late Professor Michael Blackman for sharing his extensive knowledge and expertise and for his valuable contributions to this process.

CONFIDENTIAL

Foreword by Mandisi Mpahlwa, Minister of Trade and Industry

In the last ten years our economy and its legislative framework have undergone a massive programme of reform. Many feel that we have had almost too much change. However, this reform has been fundamental to our future and is driven both by our new democratic dispensation and the pace of change in the global economy. The further reform process proposed in this policy paper is indeed somewhat overdue.

Company law provides the legal basis for one of the most important institutions organising and galvanising the economy, namely, corporate business entities. Corporations, in various forms, are central to a country's economy and its prosperity – for wealth creation and social renewal. The decision of the Department of Trade and Industry in South Africa (**the dti**) to review and modernise company law in this country was based on the need to bring our law in line with international trends and to reflect and accommodate the changing environment for business, both in South Africa and globally.

The current framework of South African company law is built on foundations, which were put in place in Victorian England in the middle of the nineteenth century. Since the introduction of the 1926 Companies Act there has been only one significant review of company law, which was initiated in 1963 and culminated in the Companies Act, 1973. Although a major review of company law in South Africa, the 1973 Act is still based on the framework and general principles of the English law. Significantly, the framework upon which our company legislation is based has been questioned in the land of its origin, England, where the review of core company law resulted in the publication of the final report of the Company Law Review Steering Group in July 2002.

This review of company law in South Africa is now a priority. South Africa has fundamentally changed since the last review of its company law. A new constitutional framework and political, social and economic environment have been established post 1994. Corporate governance and other legislative developments since the 1990s have further underscored the need for reform. In addition the South African and global economies are significantly altered in their functioning.

CONFIDENTIAL

This policy paper sets out the basic approach that we intend taking in the reform and sets the framework for detailed technical consultation to ensure that we have company law, which is up-to-date, competitive and designed for a modern corporation that is not only a domestic institution operating in a new environment but also an international competitor. We also have to take into account that these days many companies are global and operate in many economies and jurisdictions, not only that of South Africa.

We are presented with an important opportunity to carry out path breaking changes in our commercial environment that will benefit our economy and citizens.

Mandisi Mpahlwa, MP

Minister of Trade and Industry

CONFIDENTIAL

Table of Contents

CHAPTER 1: COMPANY LAW FOR THE 21ST CENTURY

1.1	Introduction	p. 7
1.2	The objectives of new company law	p. 8
1.3	The scope of the review	p. 9
1.4	Conclusion	p. 11

CHAPTER 2: THE HISTORY OF COMPANY LAW AND THE NEED FOR REFORM

2.1	The evolution of company law in South Africa	p. 12
2.2	The need for reform	p. 13
2.2.1	A changing environment	p. 13
2.2.2	A new constitutional dispensation	p. 14
2.2.3	The need for modernisation	p. 15
2.2.4	The treatment of non-profit and other organisations	p. 18
2.3	Conclusion	p. 18

CHAPTER 3: THE GENERAL PRINCIPLES OF NEW COMPANY LAW

3.1	Introduction	p. 19
3.2	The scope of company law	p. 19
3.2.1	Introduction	p. 19
3.2.2	A history of the debate	p. 20
3.2.3	Company law reform and corporate objectives	p. 24
3.3	A simple, comprehensive and accessible legal framework	p. 27
3.4	Accountability and transparency	p. 28
3.5	Harmonisation with other company laws	p. 28
3.6	Conclusion	p. 29

CONFIDENTIAL

CHAPTER 4: GUIDELINES FOR NEW COMPANY LAW

4.1	Introduction	p. 30
4.2	Company formation	p. 30
4.3	Corporate finance	p. 32
4.3.1	Shares and share issuance	p. 32
4.3.2	Capital maintenance	p. 33
4.4	Corporate governance	p. 35
4.4.1	Shareholder and investor protection	p. 35
4.4.2	Directors and the structure of the Board	p. 37
4.4.3	Disclosure and reporting	p. 39
4.5	Mergers and takeovers	p. 40
4.6	Insolvency and corporate rescue	p. 41
4.6.1	Winding up and insolvency	p. 42
4.6.2	Corporate rescue and judicial management	p. 42
4.7	Administration and enforcement	p. 43
4.7.1	A new Companies and Intellectual Property Commission	p. 44
4.7.2	The Companies Tribunal	p. 47
4.7.3	Dispute resolution	p. 48
4.7.4	Company law reviews	p. 48
4.8	Conclusion	p. 48

CHAPTER 5: THE WAY FORWARD

p. 49

CONFIDENTIAL

Chapter 1**Company law¹ for the 21st century****1.1 Introduction**

In November 1997, **the dti** issued "Proposed Guidelines for Competition Policy", which outlines a broad legislative reform programme that included a review of existing securities regulations; institutions with principal oversight of corporate structure; and current practices and regulations in the area of corporate governance.

Since the publication of the Competition Policy in 1997, a number of events have had an impact on company law. For example, a Securities Services Bill and a Financial Reporting Bill have been prepared, and the second King Report on Corporate Governance has been published.

However, no comprehensive reform of company law has taken place since the investigation of the Van Wyk De Vries Commission, which was appointed in 1963. By contrast, over the past ten years, a number of countries have undertaken extensive reviews of their domestic company law.² During the same period, a series of spectacular corporate failures have focused attention upon the need for improved corporate governance in many countries, not the least being the USA, which has recently passed the Sarbanes-Oxley Act.

This policy paper sets out the framework and guidelines for more detailed technical consultation, which will provide the foundation for the drafting of a new Companies Act. Although the intention is to engage in a comprehensive review of company law, it is not the aim of **the dti** simply to write a new Act by unreasonably jettisoning the body of jurisprudence built up over more than a century. The objective of the review is to ensure that the new legislation is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and an open economy. Where current law meets these objectives, it should remain as part of company law.

CONFIDENTIAL

For these reasons, this document intends to make the case for reform, set out a clear purpose and scope for company law for South Africa in the 21st century and then apply that defined purpose and scope to identify and describe the principal areas of company law to which careful consideration will be given. The objectives set out in this document will be subjected to public scrutiny.

1.2 The objectives of new company law

The review of this area of law should be undertaken with the understanding of the role of company law in the 21st century and its role in the economy as a whole. The Government's vision for the South African economy is captured in the Integrated Manufacturing Strategy (IMS) of the dti. The introduction of the IMS states that: -

'Our country needs an economy that can sustainably meet the needs of all our economic citizens – our people and their enterprises. This means access to quality work and enterprise opportunities, and access to the capacities and skills to make use of these opportunities. Enterprises of all types and sizes will have to become adaptive, innovative and internationally competitive.' (p .2)

In realizing this vision, a key role for government is to ensure that the regulatory framework within which enterprises operate promotes growth, employment, innovation, stability, good governance, confidence and international competitiveness. Regulation should be consistent, effective, predictable, transparent, fair and understandable. It should provide flexibility and promote adaptability to an environment with fast changing technologies, economic opportunities and social circumstances. The regulatory scheme should not create artificial preferences and distortions, where these are unnecessary. And it should attempt, where practically possible, to balance the competing interests of economic actors and of society at large.

The regulatory policy also needs to recognise the unique South African context and promote equity in a manner consistent with the South African constitution. As reflected in the recent 'Towards A Ten Year Review,' performed by the government,³ South Africa has made significant strides over the past nine years of democratic government in terms of development - socially, politically and economically. However, the Review⁴ concludes that

CONFIDENTIAL

"two economies" appear to persist in this country. "The first is an advanced, sophisticated economy, based on skilled labour, which is becoming more globally competitive. The second is a mainly informal, marginalised, unskilled economy, populated by the unemployed and those unemployable in the formal sector. Despite the impressive gains made in the first economy, the benefits of growth have yet to reach the second economy, and with the enormity of the challenges arising from the social transition, the second economy risks falling further behind if there is no decisive government intervention."⁵

Taking into account the vision of the economy and the particular challenges that South Africa faces, we believe that company law should promote the competitiveness and development of the South African economy by: -

1. Encouraging entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formalities of forming a company and maintaining its existence, thereby contributing to the creation of employment opportunities;
2. Promoting innovation and investment in South African markets and companies by providing a predictable and effective regulatory environment and flexibility in the formation and the management of companies;
3. Promoting the efficiency of companies and their management;
4. Encouraging transparency and high standards of corporate governance, recognising the broader social role of enterprises;
5. Ensuring compatibility and harmonisation with best practice jurisdictions internationally.

1.3 The scope of the review

The reform of South African Company law will involve an overall review of company law, that is the Companies Act, 1973, the Close Corporations Act, 1984, and the common law relating to these corporate entities. The review will not include partnership law.

In general terms, the task of the review will be to develop a legal framework, based on the principles reflected in the Companies Act, the Close Corporations Act, and the common

CONFIDENTIAL

law, which cover the requirements for the birth, existence or maintenance, and death of companies. The review will identify the fundamental rules governing the procedures for company formation, corporate finance law, corporate governance, mergers and acquisitions, the cessation of the existence of a company and the administration and enforcement of the law. The review will also consider the relationship between company law and other rules and measures for the protection of the interests of shareholders, creditors, employees, and other participants and interests, such as the state, the environment, the consumers, the suppliers and Black Economic Empowerment initiatives (BEE).

In so far as administration and enforcement are concerned, one issue for the review will be the balance between civil, administrative and criminal sanctions. This is important considering that the existing Companies Act too readily invokes criminal penalties, when civil or administrative remedies could be more appropriate. We acknowledge that the enforcement mechanisms currently in place are complex, with responsibility shared between the dti and a variety of other bodies including the Johannesburg Securities Exchange SA (JSE), the Financial Services Board and the Director of Public Prosecutions. It is intended that the review will address the institutional requirements to ensure simplicity and effective and consistent enforcement and to clarify roles and responsibilities.

The review will extend to the law relating to the non-profit organisations and co-operatives. Many non-profit organisations are incorporated under section 21 of the Companies Act and the implications of changes for these charitable companies cannot be overlooked. In addition, the consistency and relationship between Company Law and Co-operatives legislation, as far as co-operatives as commercial entities are concerned, will require consideration. It is particularly important that co-operatives, as commercial entities, are subject to the same rules regarding formation, governance and capitalisation as companies, so that members of the public and creditors receive the same level of protection in their dealings with co-operatives and so that no legal loopholes are created for the circumvention of basic company law principles.

As this review is initiated, investor confidence around the world, and particularly in the US, has been badly shaken by events at Enron, WorldCom, Tyco, Adelphia, Vivendi and Parmalat, to name but a few. Indeed, the actions of a small number of people have had

CONFIDENTIAL

immense repercussions on the whole business community. Furthermore, the accountancy and auditing professions have been badly reflected as a result of those events. The government has resolved to make improvements to accounting standards and the regulatory framework for accountants to ensure the promotion of the continued integrity of financial markets. The National Treasury is currently exploring a new Accounting Professions Bill to address these issues. While the need for the legal backing of accounting, and possibly auditing, standards has been clearly determined, debates are still ongoing about the best mechanism to achieve this objective. The National Treasury and the dti will be working closely together to ensure that company law and the regulation of the accounting profession is complementary.

As is clear from the above, an extensive review of current company law is desirable, timely and necessary. This review would be broadly consultative to allay fears on the part of business of unnecessary reforms that may create uncertainty. Careful consideration should be given to developments and best practice internationally and the possibilities for their adaptation to the South African context, particularly in the light of the legal framework brought about by the Constitution.

1.4 Conclusion

The overriding issue for any market-based economy is vibrant capital formation and deployment. It has aptly been said that company law is to business as the shell is to the oyster: It is what goes on inside that counts most. Good company law can create a protective and fertile environment for economic activity but it cannot, by itself, create that activity. Economic citizens in creating such activity respond to a wide range of incentives and disincentives, one of which is a clear, facilitating, predictable and consistently enforced governing law. The development of such a law is the purpose of this review.

CONFIDENTIAL

Chapter 2**The history of company law and the need for reform****2.1 The evolution of company law in South Africa**

Company law has existed in South Africa since 1861, beginning with the Joint Stock Companies Limited Liabilities Act No 23 of 1861 of the Cape Colony, which, along with other provincial company legislation, was a carbon copy of equivalent English legislation. The first national company law was introduced in 1926 with the Union Companies Act, which was amended from time to time along the lines of the latest English legislation. The 1926 Act was replaced in 1973 with the Companies Act No 61 of 1973, which, despite efforts to innovate and develop a direction more appropriate for South Africa, remains much in the mould of English law.

The current framework of company law in South Africa is therefore essentially built on foundations, which were put in place by the British in the middle of the 19th century.⁶ The 1973 Act, hailed as cutting the umbilical cord between the South African and English company law, however, adopted many of the principles and provisions of the 1926 Act. It is therefore still based on the framework and general principles of the English law.⁷ Most amendments to the Companies Act, with the exception of the establishment in 1989 of the Securities Regulation Panel to regulate takeovers and changes of control in a company, have been of a technical nature. Thus, the last extensive reform of company law occurred in South Africa in 1973 with the enactment of the existing company law, and even then the model remained that of the 1926 Act.

Perhaps the most significant departure from the United Kingdom occurred with the adoption in 1984 of the Close Corporations Act, No 69 of 1984. The new law was inspired by an English policy document recommending the introduction of a new form of incorporation for small companies, which, ironically, was never implemented in the United Kingdom. The purpose of the Close Corporations Act was to provide a simple, inexpensive business entity offering limited liability for a single person enterprise or one involving a small number of persons, which has been largely successful, as is witnessed by the large

CONFIDENTIAL

number of close corporations that are registered with the Companies and Intellectual Property Registration Office (CIPRO).

2.2 The need for reform

2.2.1 A changing environment

Internationally, company law review is a continuous process that ensures that the laws are reflective of market practices and societal needs. The South African Companies Act, 1973, is 30 years old and has not been subjected to a comprehensive review to reflect the fundamental developments that have taken place in South Africa and elsewhere.

The domestic and global environment for enterprises has changed markedly since the 1970s. Corporate structures and financial instruments have undergone significant developments. Many old concepts have been abandoned or modified and new concepts have been developed. We now live in a world of greater globalisation, increased electronic communication, greater sensitivity to social and ethical concerns, fast changing markets, greater competition for capital, goods and services. South Africa cannot afford to be left behind. There is a growing recognition by companies and governments that there is a need for higher standards of corporate governance and ethics and greater interdependence between enterprises and the societies in which they operate. A number of corporate failures in South Africa and other jurisdictions have revealed serious defects in the prevailing standard of corporate governance and the administration of the law and have resulted in investors suffering extensive losses.

Socio-political and economic change in South Africa has underscored the need for social responsiveness, transparency and accountability of enterprises. The mobility of international capital has highlighted the need for domestic laws to be investor friendly and competitive with international trends. The rise in international trade and foreign investment since 1994 has made necessary the harmonisation and modernisation of company law, as well as the need to make specific provision for foreign companies to operate in South Africa. This is further underscored by South Africa's reintegration into the region and the role that the country and domestic companies play in the economic development of

CONFIDENTIAL

Southern Africa and Africa in general. Finally, the growth of the small business sector has created a need for simpler and more accessible laws.

These factors have contributed to fundamental changes in the environment in which business operates and the consequential need for a comprehensive company law review.

2.2.2 A new constitutional dispensation

Since the Companies Act was enacted in 1973, fundamental legal developments have taken place in South Africa. The most important change was the adoption of the Constitution in 1996.⁸ No area of South African law can be analysed or evaluated without recourse to the Constitution, which is the supreme law of the country. The Bill of Rights, as provided for in Chapter 2 of the Constitution, constitutes a cornerstone of democracy in South Africa. It enshrines the rights of all people in the country and affirms the democratic values of human dignity, equality and freedom. It also regulates the relationship between economic citizens and thus may have fundamental implications for company law.

Since 1994, government has set out to dismantle apartheid social relations and create a democratic society based on equity, equality, non-racialism and non-sexism, in line with the Constitution and the Reconstruction and Development Programme (RDP). The principles of the Constitution are reflected in the policies that informed legislative reform processes since 1994. Legislative and other measures, which reflect these constitutional principles, include the attempt to balance the interests of employees and employers and to enhance equity in employment, as captured in labour legislation, particularly the Labour Relations Act of 1995, the Employment Equity Act⁹ and the Skills Development Act.¹⁰ Other measures include the recently promulgated Broad Based Black Economic Empowerment Act,¹¹ the Competition Act, 1998, environmental regulation,¹² as well as promotion of access to information by stakeholders, particularly in a corporate setting.¹³

New company law should therefore be consistent not only with the Constitution of South Africa and the principles of equality and fairness that it enshrines, but also with other laws that have been enacted, including the BEE Act, competition law, environmental law and access to information legislation.

CONFIDENTIAL

is still highly formalistic in nature, making it difficult for unsophisticated entrepreneurs to commence business and ensure its effective management. The requirement in the Close Corporations Act that only natural persons may register as members precludes certain categories of equity financiers from investing in these business entities. The scope and breadth of liability for corporate debt currently in the Act may easily expose unsophisticated investors to personal liability. There is thus a need to review the current business forms available for the registration of enterprises with a view to providing the best form of incorporation, especially for people forming a business for the first time.

The rules relating to capital require review. The continued need for the concept of par value has been questioned within South Africa and has been abolished in other jurisdictions. Par value was originally developed in the early days of companies to ensure "equitable contribution," i.e., equal pro rata payment by shareholders for shares issued by the corporation. The par value may have been intended to represent some sort of measure of value. This purpose was long ago abandoned as economically unrealistic. Par value and its corollary, stated capital (par value per share multiplied by the total number of shares outstanding), were employed as part of an equation determining whether the corporation could pay dividends or make other distributions to its shareholders.¹⁶ Under this equation, a corporation may not pay a dividend or make another distribution unless the sum of its assets at least equals the sum of its liabilities and its stated capital. To put it in other words, a corporation could make distributions only out of "surplus." With the development of low-par and no-par share, this reason for par value has also fallen away. Today, it is widely recognised that par value is economically insignificant and artificial.

The other main purpose that par value serves is of course that shares cannot be issued at a discount to par. It thus provides a floor but no ceiling to the issue price. Historically that was seen as some degree of protection to existing shareholders. The par value formed part of the concept of capital maintenance which now is superseded by more sophisticated concepts. The idea, put simply, was that the price of limited liability was that the shareholders' capital had to rank behind the creditors and therefore could not be withdrawn. The main criticism against capital maintenance is that nowadays, adequate creditor protection can be obtained without the rigidity that this system requires, provided, of course, that other areas of law, such as Insolvency Law and Tax Law, are reviewed to ensure consistent treatment throughout the broader regulatory framework. There is

CONFIDENTIAL

2.2.4 The treatment of non-profit and other organisations

The Companies Act, 1973 makes provision for the establishment of an association not for gain, commonly described as a section 21 company. It is estimated that there are approximately 11, 000 section 21 companies registered in South Africa. These types of companies are not established with a share capital, given the nature of their objectives and work. And yet, they are faced with the same administrative and financial burden as a company with share capital.

It is therefore necessary for specific provision to be made for non-profit companies when reforming the Companies Act to ensure that these types of companies are not faced with the same requirements regarding share capital, but still comply with principles of sound governance, accountability and the protection of creditors. In a similar vein, thought should also be given to the treatment of commercial co-operatives, or rather, co-operatives that are established as business entities. However, any provisions in company law in this regard would have to be consistent with the Non-profit Organisations Act¹⁷ and any Co-operatives legislation.

2.3 Conclusion

The weaknesses in current company law and the changes to the nature of the global and domestic economy together with the constitutionally mandated process of transformation of South African society compel a comprehensive review of South African company law.

CONFIDENTIAL

Chapter 3**The general principles of new company law****3.1 Introduction**

While the detailed provisions of new company law will follow from an extensive review and assessment of existing provisions and international developments and best practice, it is necessary at the commencement of the reform process to provide guidelines and policy direction on some of the core areas of company law and its reform. While it is important that change is not made for the sake of change alone, the South African Companies Act is thirty years old, largely out of line with modern business practices and deficient in some critical areas, notably in the area of shareholder protection, capital rules and corporate governance generally. The approach to new company law should therefore be to make a fresh start, to build on those existing provisions that work and are appropriate, but also to introduce new provisions and requirements. In considering new requirements and measures, international developments and best practice will be considered.

3.2 The scope of company law**3.2.1 Introduction**

Every company law reform process begins with the fundamental question 'in whose interest should the corporation be run?' It is common cause that the law requires directors to exercise their powers for the benefit of the company as a whole.¹⁸ The main question that follows from a duty formulated in this manner is what constitutes 'the benefit of the company'? Does the phrase mean that the directors should use their powers to promote the welfare of the legal entity (and what would that mean divorced from the interests of the various parties that have an interest in it), or should a broader interest be promoted? If the interests of specified groups should be advanced, which group should it be, should it be shareholders alone, or shareholders and other stakeholders? If only shareholder interests should be advanced, what of the interests of other stakeholders? Further, what mechanism should be adopted to advance and enforce such a duty? This document seeks to provide some answers to these questions in the uniquely South African context.

CONFIDENTIAL

3.2.2 A history of the debate

In terms of common law, directors are obliged to act honestly in the interests of the company.¹⁹ This position was stated as far back as 1883 in the English case of *Hutton v West Cork Railway*²⁰ where the court stated that: 'the test...is not whether [the action] is bonâ fide, but whether, as well as being done bonâ fide...it is reasonably incidental to the carrying on of the company's business for the company's benefit.'²¹ The court went on to say that '[t]he law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company'.²² Subsequent to this decision, courts in the UK as well as the USA, interpreted the benefit [or interest] of the company' to mean the long-term interests of members [or shareholders] as a whole.²³ Thus, as early as 1902, the question regarding what constitutes 'the interests of the company' seemed to have been settled.²⁴ Accordingly, ever since, the interests of the company have generally been interpreted as the interests of the members.²⁵

The fact that the interests of the company are interpreted as long-term interests of shareholders as a whole does not necessarily mean that the profits thus maximised should be distributed to them at once.²⁶ The directors are perfectly entitled to retain what they deem to be a suitable portion of the earnings for further expansion and strengthening of the enterprise.²⁷ Indeed, by retaining such profits, directors would be hoping to increase or maximise shareholder value in the future. Parkinson²⁸ submits that directors are 'not obliged to maximise current profits in order to satisfy short-term demands for dividends at the expense of a growth in profitability over a long period. They are entitled, in other words, to regard the members' interest in the company as being in general a continuing one.' This position was accepted in South Africa as far back as 1903.²⁹

There are theoretical economic underpinnings of the traditional shareholder-centric approach, which are worth mentioning, namely –

- (i) It is the shareholders who invested their capital in the company and so they are entitled to its profits after other claims are satisfied;
- (ii) The shareholders, as residual claimants of whatever is left over after all other claims have been paid, are best positioned to police the efficiency of the company; and

CONFIDENTIAL

- (iii) The survival and economic success of a company will deliver social benefits to many stakeholder constituencies, which will not be delivered if the company is a financial failure.³⁰

Although the question seemed to have been settled by the latter part of the 19th century, by the early 20th century this legal position became the subject of fierce debate and disagreements.³¹ At least since the publication in America by Professor Dodd of his article entitled 'For Whom Corporate Managers Are Trustees'³², the logic of obliging directors to act primarily for the benefit of shareholders was open to question.³³ Another school of thought emerged that directors should be obliged to benefit, in the exercise of their powers, not only the shareholders but also other groups affected by the activities of the company. Having disputed the jurisprudential efficacy of obliging the directors to be trustees for groups other than the shareholders alone, Berle later accepted that it should indeed be the case that directors be obliged to act as trustees for groups other than shareholders.³⁴

Despite the reluctance of courts to accept an expansion of the interests of the company to include the interests of groups other than shareholders, the issue remained in the public domain. The debate resumed in earnest in the aftermath of corporate governance reforms undertaken in many parts of the world in the late 1980's and early 1990's. With the commencement of an earnest debate on the issue of corporate governance, this question of stakeholder concerns was revived, that is for whose interests should the company be managed – shareholders alone or shareholders and groups other than shareholders.³⁵

There is a considerable body of opinion, which strongly endorses the idea that corporate governance is concerned with holding the balance between economic and social goals with the result that corporate governance should be seen as the system by which organisations are or ought to be governed and controlled with the contribution of and for the benefit of all stakeholders, including shareholders, employees, creditors, suppliers, and the society at large.³⁶ According to this view, companies should be run as communities in partnership with all their stakeholders. The approach focuses on the 'entire network of formal and informal relations that determine how control is exercised within companies and how the risks and returns from corporate activities are allocated.'³⁷

CONFIDENTIAL

Thus, a company's existence and success are seen as inextricably intertwined with the consideration of the interests of its employees and others potentially qualifying as 'stakeholders' in the business, such as suppliers, customers, lenders and perhaps society at large.

At least in the American jurisprudence, there is a general acknowledgement of the primacy of interests of shareholders but in many states there is a recognition of the interests of other constituencies, particularly in situations where the two are likely to come into conflict (as, for example, is often the case in a takeover bid). Sometimes this tension is reflected in the state company statutes. The Massachusetts corporate code, to take just one example, includes the following provision:

*'In determining what he or she reasonably believes to be in the best interest of the corporation, a director may consider the interests of the corporation's employees, suppliers, creditors and customers; the economy of the state, region and nation; community and societal considerations; and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.'*³⁸

Sometimes this balance is struck through court decisions. In the absence of a 'constituency' statute like the one cited above, the general rule in US jurisdictions would be that other stakeholder interests can only be taken into account 'through the prism of shareholder interests.' However, there are certain cases, within the American jurisprudence, often in the context of determining directors' duties in responding to a takeover bid, which are difficult to explain on a pure shareholder predominance theory.³⁹

A very illuminating discussion of possible interpretations of 'the interests of the company' is provided by the 1999 UK's DTI Consultation Paper entitled "Modern Law for Competitive Economy: The Strategic Framework."⁴⁰ This consultation paper set in motion the review of core company law undertaken in the UK by the DTI and which culminated with the publication of a white paper on modernising company law⁴¹ in July 2002. The consultation paper identifies three different approaches to the issue.⁴² First the traditional shareholder oriented model prevalent in the UK. In this model only the shareholders are considered as the focus of corporate activity. Second the 'enlightened shareholder value' approach. In

CONFIDENTIAL

this model directors should have regard, where appropriate, to the need 'to ensure productive relationships with a range of interested parties - often termed 'stakeholders' - and have regard to the longer term, but with shareholders' interests retaining primacy.'⁴³ In other words directors could prioritise stakeholders but only if it promotes the success of the company for the benefit of the members as a whole. Third was the 'pluralist' approach. The 'pluralist' approach asserts that 'co-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders' interests with those of others committed to the company.'⁴⁴

The various approaches attempt to define what the 'company' constitutes within the context of the duty of directors to act in the best interests of the company. The 'enlightened shareholder value' approach suggests that the term 'the company' (within the phrase the interests of the company) is to be associated primarily with the shareholders with the possibility of others being included if their interests promote the interests of shareholders. Pluralism associates the phrase with the shareholders plus other participants. According to the pluralist theory, the directors may, in certain instances, ignore the interests of shareholders, in favour of other interests in corporate decision-making. Thus interests of other stakeholders have independent value and are not subordinated to those of shareholders.

Implementation or adoption of the pluralist theory would almost invariably necessitate changing the legal position to define 'interests of the company' as being identified not only with shareholders but also with other stakeholders. However, under the enlightened shareholder value approach little reform would be needed since the approach is not dependent on any change in the ultimate objective of companies, that is, shareholder wealth maximisation.⁴⁵ The consultative paper recommended the adoption of the enlightened shareholder value approach, concluding that directors are obliged to promote the success of the company in the collective best interests of shareholders,⁴⁶ which includes, as the circumstances require, the company's need to foster relationships with its employees, customers and suppliers.⁴⁷ However, the consultative paper also recommends the inclusion of stakeholders in the proposed enlightened shareholder value codification of directors' duties, as well as additional informational requirements for companies in respect of stakeholders.⁴⁸ The proposed statutory statement thus makes clear that directors must take account of the long- as well as the short-term consequences of their actions and

CONFIDENTIAL

spells out the need to take account of, for example, employee relationships, the local community and the physical environment, in deciding how the interests of the shareholders are most effectively advanced. An integral part of this approach also consists of the Operating and Financial Review, which requires directors to report on these issues.

In addition to the largely academic and legal debates that have taken place, there have also been voluntary business initiatives. One such initiative is the Global Reporting Initiative (GRI), an independent institution with a largely corporate membership base, whose mission is to develop and disseminate globally applicable Sustainability Reporting Guidelines. The Guidelines direct companies who wish to report on the economic, environmental and social dimensions of their activities, products, and services. Thus, while debates about the correct regulatory approach have been ongoing, in some instances, companies have taken the initiative and implemented on a voluntary basis, what has been debated in law.

3.2.3 Company law reform and corporate objectives

While there has been considerable debate about the primacy of the interests of shareholders over those of other stakeholders in academic and policy literature, the question must ultimately be assessed within the particular context of South Africa.

As already noted, the legislative framework, which developed in this country as a result of the implementation of the new constitutional dispensation since 1994, necessitates extensive reform of this area of law. Traditional company law (prior to 1994) enabled companies to embark strictly on the 'shareholder-oriented approach', the main focus being on the owners of equity. The emphasis, in accordance with traditional company law, has been on the role of directors, auditors and shareholders in managing and overseeing the company's business primarily for the benefit of the shareholders. Most of the checks and balances on the powers of the controllers of the company were aimed at considering, primarily, one interest group, namely members of the company. In terms of this approach, the interests of the shareholders are paramount and interests of other stakeholders are considered only if their advancement will lead to shareholder value maximisation, that is, 'through the prism of shareholder profit maximisation.'⁴⁹

CONFIDENTIAL

Whatever the theoretical merits of this approach, South African law needs to take into account the unique South African context, including the best interests of South Africa and its citizens and the mandates of the Constitution. It is proposed that in the South African context, the company law needs to take account of stakeholders such as the community in which the company operates, its customers, its employees, its suppliers and the environment in certain situations mandated by the Constitution and related legislation. Thus, it is proposed that in the running of a modern South African company consideration has to be given not only to economic factors but also to social and environmental ones. This is what King II refers to as a Triple Bottom Line approach.⁵⁰ In South Africa, this is particularly true given its peculiar social and political history.⁵¹ On this approach, company law review in this country would not only follow the world trends but will take into account the country's particular circumstances and the legislative environment.⁵²

In view of the above, this policy framework therefore proposes the following model:

'a company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies'

In other words, in enhancing economic success of the company (corporate profit and shareholder gain), directors should take account of the policies and principles that are reflected in the Constitution and various kinds of regulation for the benefit of other groups.

This formulation seeks to recognise that if company law is to remain congruent with the Constitution and consequential legislation, the interests of shareholders should be balanced with those of other stakeholders when this is appropriate and/or required by the Constitution and related legislation.⁵³ South Africa's legislative framework therefore reflects the recognition that the company is a social as well as an economic institution, and accordingly that the company's pursuit of economic objectives should be constrained by social and environmental imperatives, some of which are provided for in legislative enactments.

This means that, unlike the traditional company law position, under the constitutional framework, stakeholder interests, in addition to those of shareholders, have independent

CONFIDENTIAL

value in certain instances. Directors may, in certain situations, have a specific duty to promote the stakeholders' interests as ends in themselves. For example, a company may find itself forced to provide access to information to an employee in accordance with the legislation, which advances the Constitutional right of access to information, even though this may be prejudicial to shareholder value maximisation. Further, promoting employee welfare (in certain situations)⁵⁴ may be an end in itself, and not only a means to promoting shareholder welfare. Expressed differently, advancing the interests of other stakeholders is not invariably a subordinate consideration to the primary goal of directors to act in the best interest of the shareholders as a body.

Although company law is subject to the supremacy of the Constitution, like any other law in South Africa, there are also other means for facilitating social change. The advancement of certain stakeholder interests may best be effected through separate legislation. If social and environmental changes were to be effected through the medium of company law alone, such change would have an impact only on South African incorporated companies and may not impact on overseas companies operating through a branch in South Africa, or to partnerships or sole traders. This would create an uneven playing field to the detriment of South African companies, would result in the implementation of social change in a fragmented manner and create incentives for circumvention. Thus, Black Economic Empowerment is best dealt with in specific law, as are matters regarding the environment and employees. Furthermore, allowing enforcement rights for all legitimate stakeholders in company law would lead to multiplicity of unnecessary and avoidable litigation. Thus, it is the conclusion of this policy document that company law must acknowledge that companies as economic agents have an impact on society and therefore on a broader range of stakeholders. However, some of those relationships, such as those with workers, are best regulated through specific laws. The recognition of the public interest in new company law can be best effected through mechanisms that are facilitative, such as optional board representation for stakeholders and provision for charitable or social contributions to be made under certain circumstances, and that are disclosure related. In addition, codes of best practice may also play a crucial role in ensuring advancement of stakeholder interests. However, what is clear is that there is a need to promote and facilitate a greater emphasis on corporate citizenship. A combination of statutory and voluntary measures are proposed.

CONFIDENTIAL

This framework policy document further acknowledges that not all companies are set up for standard business purposes. For example, there are charitable companies and special purpose ones, such as those owning the assets of clubs or societies. It is proposed that in the context of South Africa, charitable and related not-for-profit companies should be run for the purposes of achieving any charitable or not-for-profit objects identified.

3.3 A simple, comprehensive and accessible legal framework

Having clarified the question at the heart of any company law, it is necessary to outline other general guidelines for new company law. In particular, new company law should be simple, comprehensive and accessible to business people and their advisors. Simplicity should be a guiding principle in the language used, the manner in which the provisions are drafted and in the grouping of subject matter and, most importantly, the processes embodied in it, including the requirement for court approvals and the requirements for the lodgement of documents. A core principle will be the facilitation of electronic lodgement and communication as far as possible. Finally, it should be possible for small businesses and their advisors to understand the administrative requirements, without having to resort to expert advice.

Hand in hand with the need for simplicity is the need for comprehensiveness. Although the importance of the courts in developing the law cannot be gainsaid, the Act should not leave matters of fundamental importance to its schedules or to common law. Furthermore, the Act and its regulations should as far as possible combine all legislation relevant to the formation and management of companies, so that one reference is provided to business people.

While company law should be comprehensive, it should not burden companies with unnecessary rules. Company law must be facilitative, enabling and flexible. Although company law will inevitably impose restraints on the activities of companies and on those who control and manage them, its primary aim should be to make it possible for companies to structure themselves and carry on their business in the way they consider most appropriate for the conduct of their business and the administration of their affairs.

CONFIDENTIAL

Company law should therefore contain a minimum of mandatory rules and clear and enforceable prohibitions, limited to those aspects of corporate structure, governance, administration and management which must be complied with by all companies so as to ensure transparency, disclosure, the protection of legitimate interest and the prevention of fraud and improper and oppressive conduct. It is important that these rules are indifferent to form, so that they do not create artificial preferences for certain structures.

Apart from these mandatory rules, the Act should provide the maximum possible flexibility. This does not mean that companies will be regulated according to the "lowest common denominator." Rather, company law should make provision, by way of regulations, codes or default rules, for additional rules appropriate to the enterprise form, thus providing certainty and minimising costs, while at the same time ensuring flexibility.

Finally, while company law should provide for the means of co-operation among various stakeholders, it should not attempt to prescribe what the co-operation should be. Best-practice codes can also guide enterprises in their interaction with stakeholders.

3.4 Accountability and transparency

While new company law will strive to provide greater flexibility to companies, there will also be renewed emphasis on accountability and transparency. Company structure should enhance the efficient allocation of resources by creating a framework for business that requires transparency in company performance, assets and ownership. It must provide mechanisms preventing small groups from locking up assets in inefficient companies or groups of companies by ensuring that the shares of companies can be valued as accurately as possible and that the maximum possible information concerning companies is made available. Emphasis will therefore be placed in new company law on the access to and disclosure of information to relevant stakeholders, in particular to shareholders.

3.5 Harmonisation with other company laws

Harmonisation is important for at least two reasons. First, it reduces the costs and increases certainty both for overseas companies and investors, and for our own companies involved in international trade and investment. Secondly, it reduces the costs

CONFIDENTIAL

involved in the application of our company law, by enabling it to develop along the lines and in the light of a great range of judicial precedent, practice and commentary, making it more practicable, minimising uncertainty and costs and reducing the likelihood of litigation.

While the harmonisation of new South African Company law with that of international jurisdictions may be desirable, it may not always be appropriate for South African conditions. In as far as possible, harmonisation with major trading partners will be pursued. In addition, harmonisation with our company law in the SADC area will be pursued.

3.6 Conclusion

The broad policy objectives set out in this chapter are aimed at addressing the more fundamental questions that are inevitably raised in the review of legislation as fundamental to the economic system as company law. It is, however, acknowledged that in the processes of consultation and of legislative drafting further policy questions may emerge.

CONFIDENTIAL

Chapter 4:**Guidelines For New Company Law****4.1 Introduction**

Having stated some of the broader principles informing modern company law, it is now necessary, in the interests of deliberation and transparency, to describe, albeit in broad terms, the areas of company law that will constitute the primacy focus of the review process and to indicate broadly the proposed approach to be taken.

4.2 Company Formation

Company law should encourage the formation of companies of different sizes in the formal economy. This is important since the formation of companies in the formal economy will, among other things, facilitate access to capital, stimulate innovation and the growth and development of the economy generally. Individually, entrepreneurs will acquire the benefits of limited liability and portfolio diversification. In order to achieve this objective, company law should provide maximum flexibility, create sufficient certainty for equity investors and shareholders, and prevent artificial preferences for certain business forms.

The current division between close corporations, private companies and public companies offers limited opportunities for progression from one form of company to another and has resulted in distrust by financiers of close corporations. For this reason, it is necessary to move away from the largely artificial separation between the different business forms, to recognise only one formal business vehicle and to provide for a simple, easy company formation process. In implementing this single business entity, regard should be had to the desired combination of limited liability and preferred tax treatment for appropriate businesses. In attempting to simplify formation procedures, company law should take cognisance of the fact that one other key function of company formation is to permit other arms of government, notably the taxation service, to have sufficient information to enable them to perform their tasks.

It is proposed that the law should set out mandatory provisions (as far as necessary) for all companies and provide optional provisions and default provisions in cases where no

CONFIDENTIAL

election is made. The articles and memorandum of the company should provide for mandatory rules and could allow shareholders to create additional, optional and voluntary requirements. Furthermore, shareholders should have the possibility to opt out of certain mandatory rules if there is agreement amongst, for instance, holders of 90% of the shares.

It is important to recognise that companies will vary in size, turnover and in the number of shareholders. The number of shareholders does not provide an adequate basis for differentiation, as some very large companies may have a small number of shareholders. Perhaps the most important distinction is between a listed and an unlisted company. Additional rules may be imposed on listed companies, to meet the requirements of the stock exchange and to protect the investment from a multiple of small and larger shareholders, who have very limited input into the running of these companies. In addition, a further distinction may be necessary for unlisted companies on the basis of turnover, as the ability to contract and the relationship with other stakeholders, such as creditors, become more important and complex as the size and turnover of the company increases.

It is the intention to simplify formation requirements so that a layperson can form a corporation. We propose that the process of corporate formation should be automated as far as possible and, in many instances, formation should be done entirely through electronic filings. In order to create a simple and easy registration process, only the necessary information should be required. The process of updating this information should be as simple as possible to reduce the burden on companies, but also to ensure that stakeholders have sufficient information about companies to assess their risk in contracting with such companies.

It is proposed that the company should have a broad purpose, which would be to do business, or to be not-for profit. However, it must be recognized that shareholders may wish to limit the purpose of the company and should be in a position to impose such limitations. Where a company does have stated objects, a shareholder should be able to

- (i) take proceedings to restrain the doing of anything contrary to such objects (except in instances of fulfilment of an earlier obligation), without prejudice to any third party rights; and
- (ii) ratify any such acts by an ordinary resolution.

CONFIDENTIAL

Furthermore, genuine third parties (i.e. not including "insiders" such as the company's directors and people connected with them) acting in good faith should be entitled to assume a company's capacity and not be bound to enquire into the company's capacity. The above should be subject to special rules that would apply in particular cases, e.g. charities.⁵⁵

Finally, the regulation of foreign companies that establish a place of business in South Africa requires consideration. A simple process that allows foreign companies to be registered and maintained in South Africa must be developed, while providing for recourse in cases of misconduct and winding up, particularly with respect to liability for debts, the duties of foreign directors and inter group transactions. One possibility is to base such registration or recognition on a system of reciprocity or accreditation, where the formation and governance requirements of certain jurisdiction are recognised.

4.3 Corporate finance

The phrase 'corporate finance' is used to refer to the area of company law which deals with equity and debt financing of companies, share capital, acquisitions by companies of own shares and financial assistance thereof, share allotments and issue of shares, debentures and restrictions on offering shares for sale. The financing of companies is a core area of company law, impacting significantly on shareholders and other investors, while securities law, in the form of the Security Services Bill, should regulate the trade in shares and other instruments. It is equally important that this area of company law provides investors and shareholders with adequate protection, while maximising the opportunities for companies to attract capital.

4.3.1 Shares and share issuance

In increasingly time-sensitive globalizing capital markets it is important that companies attain maximum flexibility in creating financing mechanisms. This implies that they should have significant freedom to create financial instruments. New company law will facilitate this as far as possible. However, it will be necessary to ensure that share issues must be accompanied by maximum disclosure to the investing public and that there is adequate

CONFIDENTIAL

vetting of prospectuses prior to such issuance. Furthermore, the outdated distinction between share premium and par value should be abandoned, as it is largely artificial, arbitrary and detached from economic value.

It will further be investigated whether a threshold could be set for electronic registers and the issuance of uncertificated shares on a large scale. It should, however, be borne in mind that electronic registers and uncertificated shares both have their most beneficial impact on companies with highly liquid securities - the less trading in shares there is, the less the saving in moving to electronic form. It is therefore primarily relevant to listed companies. The issuance of uncertificated securities and electronic registers may require additional rules around the transfer of shares, notice to shareholders, etc.

Consideration will be given to allowing directors to issue shares, subject to shareholder agreement in the articles and to agreement by a special majority of shareholders. This would necessitate outlining a clear set of duties for directors regarding share issuance and provision for enhanced disclosure. Clear and effective rules in this regard would alleviate or prevent the problem of dilution of equity.

A further matter for consideration is whether pre-emption should be an optional rule, not a mandatory one, with the possible default position being no pre-emption. Cognisance will be taken of the fact that in small companies with a limited number of shareholders, pre-emption provides a vital protection against the dilution of shareholders' rights. Various matters, including case law, will be considered in this regard.

Finally, attention will be given to the continued need for nominee shareholding. With the advent of electronic shares and share registers, the need for nominee shareholding has largely dissipated. In the interest of transparency, consideration will therefore be given to its abolishment.

4.3.2 Capital maintenance

Share capital is not a debt owing by the company - it is equity. In the event of insolvency, members have no claim in respect of the capital contributed. Their shares are worthless, as their claims rank after all other claims. The 'capital-maintenance' rule was established

CONFIDENTIAL

well over a hundred years ago.⁵⁶ The idea underlying the rule is that creditors look to the company's funds for payment and, therefore, they stand to be prejudiced if the company pays out its funds by returning share capital.⁵⁷ The capital maintenance rule has justified the prohibition of share buy-backs, distributions to shareholders out of capital and on financial assistance for share-buy-backs.

Two primary international models exist, namely that of a capital maintenance requirement, with initial paid up capital, or alternatively a US style 'solvency-liquidity test'. Some jurisdictions, including South Africa, have sought to adopt a middle path, with elements of both schemes.

The capital maintenance rule, as implemented and refined in the US, requires that two tests should be satisfied – an equity solvency test (liquidity test) and a balance sheet solvency test (net assets or solvency test). The liquidity test requires that a company should be able to meet its cash-flow requirements and the net assets test requires that assets must exceed liabilities. In these cases, no minimum capital requirement is necessary. The essence of the American solvency-liquidity test is contained in the Model Business Corporation Act, which provides that:

'No distribution may be made if, after giving it effect:

- (1) the corporation would not be able to pay its debts as they become due in the usual course of business; or*
- (2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving distribution.⁵⁸*

The appropriateness of the US capital maintenance rule for South Africa will be investigated. Such investigation will also examine the need to align Insolvency Law and Tax Law with such a provision, in order to ensure coherence in the overall regulatory framework.

CONFIDENTIAL

4.4 Corporate governance

Corporate governance reviews have formed the core of many of the international corporate law reform processes. The focus has been on ensuring increased transparency and accountability and in a number of countries a host of additional requirements, especially in terms of reporting, have been adopted. The emphasis on the reform of corporate governance requirements in the South African context will consist of three components, namely (1) shareholders and investor protection (2) the responsibilities of the board of directors and (3) disclosure. Cognisance will be taken of the broader accountability of managers and directors not only to shareholders, but also to the State and to other stakeholders.

4.4.1 Shareholders and investor protection

One of the key functions of company law is to provide protection for investors in companies. Investors in companies can be described broadly as equity investors, employees and creditors. Employee rights are generally protected in labour law. Large creditors increasingly rely on contract to protect their investment. Equity investors are generally at the greatest risk. They invest their capital in enterprises with the intention of obtaining a return on that capital. Thus, a primary goal of company law should be to ensure that shareholders, as the investors of equity, are granted explicit rights and that they have effective recourse when those rights are violated. While the clear statement of such rights and recourse does provide protection to shareholders, it is equally important that shareholders be educated about those rights and that their statement is easily accessible in the law.

Four basic rights of shareholders can be identified, namely a right to capital, a right to income, a right to vote and a right to information. The ambit of these rights should be determined in legislation, recognising that only the latter two rights are absolute. The section below outlines some initial thoughts in this area, to give content to the proposal:

- 1) The **right to capital** is primarily concerned with the right to any residual capital that may remain after the winding up, liquidation of the company or when a capital reduction occurs. It is important that all shareholders in the same class are treated

CONFIDENTIAL

in the same manner. For this reason, share repurchases, if not available equally to all shareholders, should be subject to shareholder approval.

- 2) The **right to income** refers to the right to dividends or other forms of distributions, if there are surplus profits and a company decision has been made to distribute those profits, rather than to reinvest them. It is important to note that this right is not absolute and is intricately linked with the strategic decisions by the board of directors regarding investment in and expansion of the company. All shareholders in the same class should be treated equally and the law must provide that proportional allotments to shareholders are made in cases of distributions and dividend payments.
- 3) The **right to vote** is an inalienable right that allows shareholders to have a say in the companies they have invested in. Shareholders of the same class should have the same voting rights and decisions should be made on the basis of the majority of votes, recognising that certain decisions, such as the sale or merger of the company, may require a higher majority. Shareholders also have the right to elect directors. In order to exercise their right to vote, shareholders should be able to call a meeting. Annual General Meetings should remain compulsory, although shareholders of unlisted companies should be able to opt out of this provision with a 90% majority. In order to promote the exercise of the right to vote by shareholders, it is important that certain measures are put in place, including the facilitation of proxy voting and electronic voting. Other measures to consider could include imposing a requirement to publish voting decisions on investors in public companies with a significant shareholding, in particular on institutional investors.
- 4) The **right to information** includes both the right to receive information and the right to access information. Shareholders should be provided with information that is publicly available, including information presented to analysts. Shareholders should also be presented with sufficient and timely information in preparation of meetings. There must be full and complete disclosure of material information, with a minimum of annual financial statements. Shareholders of smaller companies should be able to opt out of the requirement for financial statements on the basis of 90% majority, to reduce the costs and compliance burden of smaller companies. In

CONFIDENTIAL

addition, shareholders should be able to access certain information from the company, upon request. The new company law will set out under which conditions shareholders can access additional information from companies and what type of information may be demanded, in order to minimize the possibility of disputes arising.

It is particularly important that effective remedies are in place for shareholders and investors to enable them to exercise their rights. These remedies are elaborated on in the policy framework under enforcement and administration. Furthermore, exit and appraisal rights should be identified and given content, particularly to provide smaller investors the ability to make informed choices, where they are unable to influence company direction and decisions effectively or to pursue private actions against the company in civil courts.

4.4.2 Directors and the structure of the Board

There has been a question in South Africa for some time whether we should follow the example of continental Europe in establishing a two-tier board or whether a unitary board structure should be required. While a two-tier board provides for the opportunity for stakeholder representation, the European experience has shown that this type of Board structure is often inefficient, may deter investment and is not necessarily desirable for stakeholders. Furthermore, South Africa has largely adopted a unitary board structure to date and imposing a legal requirement for a two-tier structure may be costly. For this reason, the position of this policy document is that a unitary board structure be retained, but that stakeholder representation on that board should be optional. The Swedish model for a unitary board with stakeholder representatives will be examined in greater detail, particularly to determine whether stakeholder representatives could be exempted from certain director's duties.

Another important issue is to clarify the rules governing the conduct of directors in South African companies and the remedies, which are available for violations of the rules. The regulation of director conduct is a very difficult and multi-faceted question. It is commonplace that directors' duties play a fundamental role in ensuring good corporate governance.⁵⁹ Indeed, directors' duties serve as a limitation on directors' powers. In South Africa, like in the UK, virtually all legal principles concerning directors' duties are found in

CONFIDENTIAL

common law, more particularly in case law that stretches as far back as the early eighteenth century.⁶⁰ Given the fact that these duties are found in mainly English cases spanning four centuries,⁶¹ there is little consensus in the legal community as to what precisely is the content of fiduciary duties of directors, which exist in common law. Furthermore, some of the cases in this area are irreconcilable and thus make it difficult to point to the existing legal position with precision or certainty. There is, nevertheless, some consensus that these common law duties of directors can be divided into two categories, namely (a) the duties of loyalty and good faith, and (b) the duties of care and skill.⁶² It should be noted that all of these duties must be exercised in the best interest of the company.⁶³

While in many jurisdictions, the duties of directors as well as standards of directors' performance have been developed in common law, there is merit in considering a statutory standard. In South Africa, research has established that management and directors are not clear about their duties. A statutory standard for conduct and a clear statement of duties would assist in capturing case law set out in other jurisdictions and would give directors a degree of certainty about their duties, the standard for their conduct and associated liabilities. A possible set of duties and standard of conduct could involve the fiduciary duties, a duty of fair dealing and care, and a duty to act in the interests of the company as an overriding duty. Directors should also have an obligation to disclose to the corporation any business opportunity that comes to the director if the director has a reasonable belief that the corporation would be interested in it, as well as the duty to disclose relevant material information not known to other directors. Finally, directors could be allowed to have regard to the interests of stakeholders other than shareholders in appropriate circumstances. However, the benefits of such a statutory standard for conduct will need to be evaluated against the constraints it will place on the development of common law.

A common debate in all jurisdictions is whether it should be permissible to exculpate, indemnify or insure directors against liability. As South Africa does not have a litigious culture, it is not necessary or desirable to exculpate or indemnify directors against liability. However, in order to enable companies to attract and retain highly qualified directors in circumstances where the actions of directors are increasingly under scrutiny, it may be

CONFIDENTIAL

necessary for a company to be able to indemnify a director against the expense of successfully defending an action against him or her.⁶⁴

Finally, the disqualification of directors should be clearly outlined in company law and should include at a minimum unrehabilitated insolvents and persons with certain categories of convictions. The English Disqualification Act provides a framework for such disqualifications and will be examined in greater detail when drafting new company law. In addition to the disqualification criteria, appropriate enforcement mechanisms will need to be put in place.

4.4.3 Disclosure and Reporting

Company law must ensure maximum possible transparency in regard to the administration of companies and the maximum possible disclosure of information concerning their affairs. Such disclosures are critical to facilitate a proper assessment of the financial position of companies and their performance. While it is primarily shareholders that have a right to information, the law must also ensure that other interested persons – such as employees and creditors – are given proper notice of all policies and decisions that will affect their interests. Disclosure and accurate reporting will therefore be considered paramount in new company law.

Disclosure should extend not only to financial information, but should also include statements on compliance with public interest legislation, including the Black Economic Empowerment Act, environmental regulation and labour regulation. This is generally described as Triple Bottom Line Accounting. Annual financial statements should contain in addition to financial information, information about the remuneration of directors and senior managers and all bonuses and distributions. In order to ensure the accuracy of this information, statutory accounting (and auditing) standards will be set out in company law by way of regulation.

Furthermore, in order to promote and foster informed and accurate comment by the financial press, consideration will be given to subjecting public announcements and information given to the press by officials of companies to the same rules that govern the truth and accuracy of information furnished in a prospectus.

CONFIDENTIAL

4.5 Mergers and takeovers

Generally, a take-over bid is an offer to all or most shareholders to purchase shares of a target (offeree) corporation, where the offeror, if successful, will obtain enough shares to control the target corporation.⁶⁵ Take-overs are an important market mechanism by which a person can seek to replace inefficient management with more competent management. Hence, take-overs can help allocate resources to more productive uses. The primary objective of the Companies Act take-over bid provisions should to ensure the integrity of the market and that the rights and interests of the various parties involved in a take-over bid (i.e. shareholders, the offeror, other stakeholders and the target corporation) are adequately protected.

It has been recently questioned in South Africa, whether takeover regulation should be regulated either through a separate law or whether the regulation of primary offers should be included in securities legislation, as is the case in some jurisdictions, such as the USA. While it appears to be generally agreed that company law should govern the regulation of primary offers, views on takeover regulation have differed. The aim is to clarify the policy position of government in this regard.

There is powerful argument that takeover regulation should properly be governed by company law, rather than securities regulation, as takeover bids are not only a matter of dealing in shares, but also involve the acquisition of the control of companies. Takeover regulation involves imposing duties on the directors of target companies, not only in regard to the actual offer, but also in regard to defensive tactics, which are all matters for company law. Finally, takeovers are an important mechanism for ensuring the efficient management of companies, a philosophical cornerstone of company law. It is therefore the position articulated in this policy framework that takeover regulation should remain part of company law.

Takeover regulation is best captured in regulation, as the rules may require adjustment to accommodate market changes. The form of the current Takeover Code, administered by the Securities Regulatory Panel (SRP), will be largely retained, as it has been aligned with international practices. A brief comparative review of the timeframes and international

CONFIDENTIAL

processes will be conducted. However, it will be necessary to ensure that the enforcement mechanisms are reviewed to ensure compliance with the Code and that alternative mechanisms for appeals are developed, as it would be preferable to avoid litigation in the case of takeover bids. These matters will be elaborated further in the section below dealing with administration and enforcement.

In addition, it will be necessary to make provisions in company law for mergers in the true sense of the word, namely, the absorption of one company into another, with the assets and liabilities of the former becoming the assets and liabilities of the latter and with the former ceasing to exist. Current company law does not provide mechanisms to combine companies, but rather requires the transfer of assets by scheme of arrangement from one company to another or third company. In order to enhance flexibility, efficiency and transparency, it is necessary that the combination of companies be facilitated through company law, so that mergers in the true sense are facilitated.

Finally, it will be necessary to ensure the harmonisation and policy consistency of competition law and company law in respect of mergers and takeovers, to reduce the compliance burdens on companies.

4.6 Insolvency and corporate rescue

The winding up of companies concerns not only creditors but also a multiplicity of interests, including members, employees, directors and officers and the public interest in the proper administration of companies. In particular, it involves shareholders' rights, the protection of their interests and the investigation of wrongdoing, the possible imposition of liability for the company's debts on the directors and officers, and questions of "insolvent trading" and its consequences. For these reasons, it is important that provisions relating to the winding-up of companies are retained in company law.

The liquidation provisions of companies are to be found in Chapter 14 of the Companies Act read together with various provisions of the Insolvency Act 24 of 1936. A further source insofar as corporate insolvency is concerned is Chapter 9 of the Close Corporations Act 69 of 1984. There are both overlaps and inconsistencies in the provisions. For example, the existence of large close corporations notwithstanding, there

CONFIDENTIAL

is no equivalent to Section 311 of the Companies Act. There is, therefore, a need for examination of the various laws affecting insolvency so that the principles in each piece of legislation promote a coherent framework. The dti will liaise closely with the Department of Justice about the proposed company law reform and the introduction of the proposed new Insolvency and Business Rescue Bill.

4.6.1 Winding up and insolvency

Within the context of changes to the law of corporate insolvency, particular attention should be given to the role and responsibilities of liquidators, the process of winding up and the powers of inquiry.

The duties imposed on liquidators in current company and insolvency law require simplification and streamlining. There is also a need to ensure proper oversight over their conduct and the accountability of liquidators. Consideration will need to be given to the need for statutory recognition of the requirements for being a liquidator.

In certain provinces, the statutory regime, which entails the granting of a provisional order prior to a final order of liquidation being granted, has been rejected in favour of a final order alone. There is considerable merit in this practice and consideration should be given to the manner in which the Act presently caters for two sets of orders, which only increase the cost of proceedings. Consideration will therefore be given to making provision simply for a final order and to allow creditors to intervene after the presentation of the application for such winding up and before the winding up order has been made.

It would appear that in certain provinces the voluntary winding up provisions in terms of section 349 of the Companies Act have been the subject of considerable abuse, particularly being used in order to obviate a possible section 417 inquiry. Consideration must be given to the manner in which these provisions should not be used so as to subvert the interests of creditors and other stakeholders. Furthermore, a re-examination of the legal architecture of section 417 enquiries will be undertaken.

4.6.2 Corporate rescue and judicial management

CONFIDENTIAL

Chapter 15 of the Companies Act, 1973, creates a system of judicial management. In practice, it would appear that the judicial management is rarely used and even more rarely leads to a successful conclusion. The legislative provisions regarding judicial management have undergone little change since they were created in 1926. By contrast, a number of countries over the past decade have introduced new systems for business rescue, including Australia and Canada.

*It has been observed that 'all modern corporate-rescues are united on one matter, the absence which, possibly more than anything else, has helped to bring South Africa's judicial management to its present perceived impotence. This is the recognition that the agreed plan by which the future relations between the debtor and its creditors will be governed may well include the reduction of the debtors overall indebtedness. To insist, as the South African rescue provision does, that a protective moratorium is available only where 'there is a reasonable probability that if [the debtor] is placed under judicial management, it will be unable to pay its debts or to meet its obligations' is to ignore the well-nigh universal reality of creditors being prepared, for their own benefit to forgive part of the debt. It is frequently the case that a creditor will benefit far more from having the debtor back in the market place than from suing the debtor into extinction. A radically new rescue provision should provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor may emerge from protection and resume normal commercial dealings.'*⁶⁶

This recommendation will be taken into consideration in the law review process in order to create a system of corporate rescue appropriate to the needs of a modern South African economy. In particular, the provisions of the US Chapter 11 will be considered. It must further be tested against the work already done by the Department of Justice in the proposed Insolvency and Business Rescue Bill.

4.7 Administration and enforcement

A primary goal of new company law will be to ensure that through a proper system of corporate governance, disclosure and exposure to market forces, wrongdoing will be discouraged and punished. Traditionally, company laws have left the enforcement of their provisions to shareholders, the liquidator in winding-up, and the Director of Public

CONFIDENTIAL

Prosecutions. Experience has shown that these methods of enforcement are inherently defective.

The decriminalisation of company law is key to ensuring more effective and credible redress. However, the simple substitution of provisions imposing criminal liability with provisions imposing personal liability on directors may compound the problem, by leaving enforcement to the shareholders and the liquidator. This approach would be dependent upon the resources available to shareholders, and, in the case of large companies, it is unlikely that directors or managers concerned will have sufficient assets to meet the liabilities thus imposed on them. Rather than shifting the burden to shareholder enforcement, an independent and suitably empowered body is necessary, charged with the duty to ensure compliance with the provisions of the Act that wrongdoers are brought to book effectively and efficiently.

While the continued role of criminal and civil courts in company law enforcement is not questioned, there is also a need for a body with the power to issue administrative orders and impose fines to ensure the quick resolution of some commercial matters, especially those relating to mergers and takeovers. Thus a combination of criminal, civil and administrative remedies should be introduced. In addition, measures to disqualify persistent violators from access to public markets and to promote dispute resolution will be considered.

The proposed new institutional framework therefore consists of a Companies and Intellectual Property Commission, a Companies Tribunal, an Arbitration Council and an Advisory Panel.

4.7.1 A new Companies and Intellectual Property Commission

The proposed new Companies and Intellectual Property Commission will have a mandate to encourage company formation and accountability through efficient and effective service delivery and through creating greater transparency in the market place. This mandate will be met through efficient registration of companies, education and awareness raising, dissemination of information company information and enforcement of company law.

CONFIDENTIAL

4.7.1.1 Company registration

The vision for company registration and the maintenance of that registration is to ensure a service that is efficient, effective and that imposes minimal constraints on entrepreneurs and business managers. The company registration service will have to be transformed into an efficient electronic registration service with expedited turnaround times. It should allow individuals to register companies or to update information through direct computer access. Access to registration services will need to be facilitated geographically, to ensure that all South Africans, even those in remote areas, are able to access the service. Additional services will need to be provided to those South Africans who are not computer literate. A network of partners will be considered, which could include provincial economic affairs offices, to ensure easy access on a national basis. In addition, electronic searches of company names and other company information will be available to expedite service. Payment systems will be adjusted to allow for direct deposit or electronic transfer, to move away from the current cash-based system.

Many of these transformation imperatives are already underway in the Companies and Intellectual Property Registration Office (CIPRO). It will, however, require further emphasis on the transformation of CIPRO from a people intensive function to a largely systems oriented institution, that can provide service levels to the public and the business community that is in line with best practice internationally.

In addition to the above transformation imperatives, the accountability of the registration service to its clients is paramount, especially in view of the fact that the registration service will be offered on a user-pay principle to enhance efficiency and accountability. To this end, service standards will be developed and published and updated information on meeting the standards will be regularly published.

4.7.1.2 Information dissemination

As the Companies and Intellectual Property Commission will have access to key economic information, it is important that that information is available to the general public at minimal cost. Stakeholders, including creditors and potential investors, should be able to access relevant information with ease. In addition, the Companies and Intellectual Property

CONFIDENTIAL

Commission should be required to make available information on the state of companies in South Africa on an annual basis. This may require additional research on companies, and their turnover, as well as reasons for exiting. This information should be available electronically and in a user-friendly manner and should be accessed through the website of the Companies and Intellectual Property Commission. Where possible, links to individual company websites could be established. In addition, additional information may be added to the company information, such as any unscrupulous activities that a company and its directors may have been involved in.

Information dissemination and availability will enhance the ability of policy makers and investors to make decisions and will increase transparency in the market place. It will further enable the "blacklisting" of companies that have been involved in unscrupulous practices.

4.7.1.3 Awareness and education

Investors and consumers are increasingly requiring companies to adopt higher standards of ethics and conduct. A critical function of the new Companies and Intellectual Property Commission will therefore be to make investors aware of their rights and the recourse available to them. Through education and awareness, greater shareholder activism can be generated. Another important function will be to educate directors about their duties and responsibilities and accredited programmes to enhance corporate governance and ethics will be put in place. Furthermore, programmes to educate companies about corporate citizenship, the concept, its implications, international initiatives; to debate its implications in the South African context; and to promote its spread in South Africa will also be adopted.

Easily accessible and user-friendly information on new company law must be made available and disseminated. In addition, 'user notes' and guidelines should be made available to guide the public and specific shareholders, but also to promote voluntary compliance by companies. The Commission should also have the power to apply to a court through a special procedure to seek clarification of any areas of legal uncertainty in the legislation.

CONFIDENTIAL

The Companies and Intellectual Property Commission will also need to initiate campaigns to promote registration of companies in the formal economy and to educate smaller entrepreneurs about the benefits. Specific outreach programmes will need to be put in place.

4.7.1.4 Monitoring and enforcement

In addition to the above core functions, another key activity of the Companies and Intellectual Property Commission will be to ensure that shareholders have recourse and redress through the effective enforcement of their rights. The intention is not to create a body that will continually interfere in the conduct of business. Rather the intention is to create a body that can, and does when needed, act swiftly and effectively to ensure compliance, prevent wrongdoing and ensure punishment for misconduct. It is proposed that this body combine the present functions of the Registrar of Companies with those of an enforcement agency. It will be vested with all such powers as are necessary to enforce the provisions of company law. These functions will include market monitoring, investigation and enforcement actions, as well as the vetting and approval of prospectuses and smaller merger and takeover bids.

4.7.2 The Companies Tribunal

It is proposed that, in addition to the Companies and Intellectual Property Commission, a Companies Tribunal and appeal mechanisms are introduced, which will adjudicate certain matters brought under the new Companies Act. While there is currently a consolidation of administrative tribunals into the High Court and Supreme Court of Appeal, a compelling case can be made for commercial matters to be dealt with through a separate administrative body that has experience in commercial matters and that can expedite the adjudicative process. In particular, where mergers and takeovers are concerned, time is of the essence. Given the synergies between company law and competition law, particularly with respect to mergers and takeovers, further consideration should be given as to whether a Companies Tribunal and appeal system should not be merged with the Competition Tribunal and Appeal Court. This would further imply that the role of the

CONFIDENTIAL

Securities Regulatory Panel, a separate adjudicative function, could be added to that of a Companies and Competition Tribunal and Appeal Court.

4.7.3 Dispute resolution

Consideration should be given to the establishment of a dispute resolution mechanism that can provide first recourse to shareholders that are aggrieved. As a matter of principle, many disagreements and disputes should be settled outside a court or tribunal system through less formal mechanisms. It may not be necessary to create a new institution for this purpose, as existing mediation mechanisms may be explicitly recognised in law.

4.7.4 Company law reviews

While the Companies and Intellectual Property Commission will necessarily make inputs into amendments and reviews of company law, consideration should be given to the role of the Standing Advisory Committee on Company Law, as a body of experts making independent inputs to the Minister of Trade and Industry. It is envisaged that an advisory committee should be retained, but that its functions will be reviewed.

Indeed, if our new company law regime is to be effective and durable, the legislative and institutional framework, which underpins it, should be one which ensures that company law can continue to keep pace with the changing needs and expectations of business and society. Thus, company law should be updated so as to keep abreast of the best international corporate practices and to deal with market developments. Appropriate institutional support will be critical to achieve this objective.

4.8 Conclusion

This chapter set out the broad areas for review. It cannot be exhaustive, as many policy and legal matters will arise during the process of drafting new legislation. However, the framework presents an outline for a modern company law for the 21st century that will form the basis of consultation with the public.

CONFIDENTIAL

Chapter 5**The Way Forward**

It is envisaged that Company Law Reform will proceed through three separate stages: consultation and finalisation of a policy framework; the preparation and review of a drafter's memorandum based upon this policy document; and the drafting, publication and consultation on new company law.

This policy document will be presented to a range of stakeholders, first internally in government, and then externally to stakeholders and customers. In addition, the policy document will be debated at Nedlac.

Concurrent with public consultation on the policy framework, **the dti**, with the assistance of local and international experts, will prepare a drafter's memorandum, which will inform the new legislation. In preparing such a memorandum, current legislation, as well as international practice and legislative provisions will be studied. The final document will draw together all the necessary research documents, will clearly outline the thinking, and will be consistent with the policy framework. It is expected that this process will be completed by December 2004.

The final stage in arriving at new company law will be the process of drafting the new law. This process will be based on the drafter's memorandum, giving effect to the policy. Once the new law has been drafted, both the legislation and the drafter's memorandum will be made public and extensive consultation on the new law will occur. It is anticipated that the new legislation will be made public by December 2005. Given the nature of the topic and its potential impact on business, it is imperative that the process is transparent and consultative and that all outputs of the process are widely publicised. The process outlined below seeks to address these principles.

A concurrent and equally important process is the establishment of the institutional framework. This will involve as a first step the transformation of CIPRO into an efficient, sustainable and service oriented company registration office. A fundamental transformation of the systems, processes and organisational orientation will be necessary.

CONFIDENTIAL

Steps will be taken to ensure that the institutional framework envisaged in this policy framework is fully operational when the law comes into effect.

Due to the extensive nature of the proposed reform, an interim review of current legislation will be performed to deal with problematic provisions, provided that any amendments are in line with the philosophy outlined in this policy framework.

Activity	End Date
Consultation with Nedlac	June – August 2004
Concurrent public consultation on the policy document	June – August 2004
Finalisation of policy framework	September 2004
Research into international and existing company law	January – September 2004
Review of legislative options & preparation of drafter's memorandum	September – December 2004
Drafting of legislation and exposure draft	January – August 2005
Cabinet approval for publication	September 2005
Publication of exposure draft for public comment, including workshops and other public consultation	September – December 2005
Evaluation of comments & preparation of revision instructions to drafters	October - December 2005
Revision of Bill by drafters	October - December 2005
Submission of Bill to Parliament	January 2006
Proclamation of Bill by President	June 2006
Launch of new institutions	June 2006

CONFIDENTIAL

¹ The terms 'corporate law and company law' are used interchangeably in this document. They both refer to the law regulating corporate entities formed both in terms of the Companies Act, 61 of 1973 and the Close Corporations Act, 69 of 1984.

² Countries such as Botswana, Hong Kong, Australia, Canada and the United Kingdom undertook extensive reviews of their corporate laws.

³ *Towards a Ten Year Review: Complete Report*, Synthesis report on implementation of government programmes: Discussion document, October 2003. Available at: <http://www.gov.za/reports/2003/10yrbook.pdf>

⁴ *Ibid.*

⁵ At 97.

⁶ See Minah Tong 'Review of Company Law in South Africa: Should South Africa Follow the British Example in Corporate Governance Matters This Time?' unpublished LLM dissertation, University of Natal, Durban (2003).

⁷ *Ibid.*

⁸ The Final Constitution Act 108 of 1996.

⁹ 55 of 1998.

¹⁰ Act 97 of 1998. In so far as skills development is concerned, government has directed resources towards education and skills training and set up Sector Education and Training Authorities for each sector of the economy, financed by a skills levy on the pay roll. Although the SETA's have been slow in meeting their objectives and employers slow to advantage of them performance is improving. See *Towards a Ten Year Review: Complete Report*, Synthesis report on implementation of government programmes: Discussion document, October 2003, 40 - 41. Available at: <http://www.gov.za/reports/2003/10yrbook.pdf>

¹¹ Recently, the Department of Trade and Industry (dti) in South Africa came up with the Broad Based Economic Empowerment Bill. This is a further attempt to encourage companies to adopt BEE initiatives, which reflect good corporate practices. The Bill, which has already been passed by both houses of parliament (the National Assembly and the National Council of Provinces), aims to establish a legislative framework for the promotion of black economic empowerment; to empower the Minister to issue codes of good practice and to publish transformation charters and to establish the Black Economic Empowerment Advisory Council, among others. The Bill acknowledges that under apartheid, race was used to control access to South Africa's productive resources and access to skills. The Bill accepts that South Africa's economy still excludes the vast majority of its people from ownership of productive assets and the possession of advanced skills. According to the Preamble to the Bill, South Africa's economy performs below its potential because of the low level of income earned and generated by the majority of its people. The Bill cautions that unless further steps are taken to increase the effective participation of the majority of South Africans in the economy, the stability and prosperity of the economy in the future may be undermined to the detriment of all South Africans, irrespective of race. The Bill was introduced in order to promote the achievement of the constitutional right to equality, increase broad-based and effective participation of black people in the economy and promote a higher growth rate, increased employment and more equitable income distribution. The Bill also seeks to establish a national policy on broad-based black economic empowerment so as to promote the economic unity of the nation, protect the common market, and promote equal opportunity and equal access to government services. All the initiatives to foster BEE will almost invariably affect the way in which companies are run. On the 9th of January 2004, President Thabo Mbeki signed the Broad-Based Black Economic Empowerment (BEE) Act into law.

¹² See, among others, the National Environmental Management Act (Act 107 of 1998) and the National Environmental Management: Air Quality Bill, 2003.

¹³ See the Promotion of Access to Information Act (Act no. 2 of 2000) and a landmark decision of *Davis v Clutchco (Pty) Ltd* (2003 All SA Reports 561).

¹⁴ See the Report on South African Companies Act No. 61 of 1973 and Related Legislation by the American Bar Association Section of Business Law Committee on Corporate Laws (2001), 4.

¹⁵ Act 69 of 1984.

¹⁶ See the Report on South African Companies Act No. 61 of 1973 and Related Legislation by the American Bar Association Section of Business Law Committee on Corporate Laws (2001), 14.

¹⁷ Act No 71 of 1997.

¹⁸ See, for example, *Re Smith & Fawcett Ltd* [1942] Ch 304, at 306)

¹⁹ This is found at common law.

²⁰ 23 Ch D 654.

²¹ At 672.

²² At 673.

²³ See the comments of the Jenkins Committee: United Kingdom, Report of the Company Law Committee (Cmnd 1749, 1962). See also *Percival v Wright* [1902] 2 Ch 421; *Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd* [1983] Ch 258; *Grove v Flavel* (1986) 43 SASR 410, 417; *Peskin v Anderson* [2000] BCC 1110. For the US, see, for example, *Dodge v Ford Motor Co* (1919) 170 NW 668; *Revlon Inc v MacAndrews & Forbes Holdings Inc*, 506 A 2d 173, 179 (Del, 1986); *Polk v Good*, 507 A 2d 531, 536 (Del, 1986).

CONFIDENTIAL

²⁴ See also *Percival v Wright* [1902] 2 Ch 421.

²⁵ I.e. shareholders.

²⁶ See Detlev, F. Vagts, 'Reforming the Modern Corporation: Perspective From the German' (1966) 80 Harvard LR, 23, at 37.

²⁷ Ibid.

²⁸ J.E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law*, (1993), at 81.

²⁹ See HS Cilliers, ML Benade, JJ Henning, JJ Du Plessis, PA Delpont, L De Koker and JT Pretorius, *Corporate Law*, 3 ed (2000), at 139 – 147. Consider the case of *Coronation Syndicate Ltd v Lillienfield and The New Fortuna Company* 1903 TS 489, at 497.

³⁰ See, among other, Trevor S. Norwitz, 'The Metaphysics of time: A Radical Corporate Vision' (1991) 46 *Business Lawyer* 377, at 377.

³¹ Compare E.M Dodd, 'For whom Corporate Managers Are Trustees?' (1932) 45 Harvard LR, 1145 and A. A Berle, 'For whom Corporate Managers Are Trustees: A Note' (1932) 45 Harvard LR, 1365. See also C.D Stone, 'Corporate Social Responsibility; What it might mean if it were really to matter' (1986) 71 Iowa Law Review 557 and Lord Wedderburn of Charlton, 'The Social Responsibility of Companies' (1985) 15 M.U.L.R 4.

³² Supra.

³³ See Detlev, F. Vagts op cit at 37.

³⁴ Compare Berle's 1932 article (supra) with his 1954 publication, *The 20th Century Capitalist Revolution*, at 169. See also Robert N. Anthony, 'The Trouble with Profit Maximization' (1960) 38 Harvard Business Review 126. This suggested reform to the legal position as advocated by a number of writers in the early and mid 20th century, spectacularly failed to receive embrace by the courts and the legislature in Britain and the United States. See Detlev, F. Vagts supra at 37.

According to Blair '[t]he idea never had much theoretical rigor to it, failed to give clear guidance to help managers and directors set priorities and decide among competing socially beneficial uses of corporate resources, and provided no obvious enforcement mechanism to ensure that corporations live up to their social obligations.' (Margaret M Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (1995), at 203)

³⁵ At least in the US, this was as a result of a political development as 'bust-up' takeovers were seen as abusive and harmful because, for example, of job losses and so several states adopted 'constituency' statutes to protect their companies and their constituents. See Trevor S. Norwitz 'The Metaphysics of time: A Radical Corporate Vision' (1991) 46 *Business Lawyer* 377, at 378 – 79.

³⁶ See some of the authorities referred in the following: BR Cheffins, 'Corporate Governance Reform: Britain as an Exporter', in B Main, (ed.), *Corporate Governance and the Reform of Company Law*, (2000) 8, Hume Papers on Public Policy at 10 – 11. See also BR Cheffins, *Company Law: Theory, Structure and Operation* (1997) chapter 3, at 151-53, chapter 13, at 574-601; R Smerdon: *A Practical Guide to Corporate Governance*, (1998), chapter 1, at 6-10. For further background, see *Company Law Review Steering Group, Modern Company Law For a Competitive Economy* (1999), chapter 5.1; J. Parkinson, 'Company Law and Stakeholder Governance' in G Kelly et al, eds, *Stakeholder Capitalism* (1997), 142 and BR Cheffins, "Trust, Loyalty and Cooperation in the Business Community: Is Regulation Required?" in B Rider, ed, *The Realm of Company Law*, (1998). A very illuminating discussion of possible interpretations of 'the interests of company' is provided by the 1999 UK's DTI Consultation Paper entitled "Modern Law for Competitive Economy: The Strategic Framework." This consultation paper set in motion the review of core company law undertaken in the UK by the DTI and which culminated with the publication of a white paper on modernising company law in July 2002.

In that consultation paper, the Steering Group identified three different approaches to the issue. First the traditional shareholder oriented model prevalent in the UK and also in South Africa. In this model only the shareholders are considered as the focus of corporate activity. Second the 'enlightened shareholder value' approach. In this model directors should have regard, where appropriate, to the need 'to ensure productive relationships with a range of interested parties - often termed 'stakeholders' - and have regard to the longer term, but with shareholders' interests retaining primacy.' In other words directors could prioritise stakeholders but only if it promotes the success of the company for the benefit of the members as a whole. Third the 'pluralist' approach. The 'pluralist' approach asserts that 'co-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders' interests with those of others committed to the company. See further Lowry and Dignam 'Company Law' (Butterworths 2003) chapter 16'. See also Trevor S. Norwitz, above, who argues that the public and judicial sentiment awakened by the takeover boom of the 1980s (coupled with dramatic growth in institutional stockholding) could well provide a catalyst for a new and more socialized vision of corporation.

³⁷ BR Cheffins, 'Corporate Governance Reform: Britain as an Exporter', in B Main, (ed.), above, at 10 – 11.

³⁸ See Mass.Gen.L. Ann., Ch.156B Section 65.

³⁹ See, for example, *Paramount Communication v Time Inc* 571 A.2d 1140 (Del. 1989).

⁴⁰ Issued in February 1999; URN 99/ 654, paragraph 5.1.

⁴¹ CM 5553.

CONFIDENTIAL

⁴² See paragraphs 5.1.12 and 5.1.13.

⁴³ Para 5.1.12.

⁴⁴ Para 5.1.13)

⁴⁵ Paragraph 5.1.17.

⁴⁶ See the Final Report by the Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy; Final Report, URN 01/942 and URN 01/943 released in July 2001, para 3.8.

⁴⁷ Ibid.

⁴⁸ See below para 3.3.1.6 for more on this and John Armour et al supra, at 1.

⁴⁹ Trevor S. Norwitz, above, at 378.

⁵⁰ See generally the Introduction and Section 4 of King II.

⁵¹ The King Report states that companies should adopt the triple bottom line approach. This approach requires companies to consider the social, environmental and economic interests in their corporate decision-making (see para 17 of the introduction to King II (2002)). The Report, however, states that companies need to consider that they are ultimately accountable to the company (see para 5 of Introduction, King II 2002).

⁵² It is important to note that in South Africa, the Constitution (Act 108 of 1996) is the supreme law of the country, meaning that law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled (see section 2). Another unique feature about the Constitution is that it does not only entrench civil right, but it has a justifiable bill of rights, which entrench socio-economic rights. These include, among other, freedom of trade, occupation and profession (section 22), labour relations (23), environment (24), property (25), housing (26), health care, food, water and social security (27), education (29), language and culture (30). These socio-economic rights are further expanded upon in legislation. Section 8(2) of the Constitution provides that a provision of the Bill of Rights binds a natural or a juristic person if, and to the extent that; it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right, thereby allowing a horizontal application of the Bill of Rights. Therefore, if, in a particular situation, any of the common law provisions (or statutory provisions), or the application thereof, like fiduciary duties to shareholders, conflicts with any of the rights in the Bill of Rights and the right cannot be justifiably limited in terms of section 36 of the Constitution, then the Court would require the company to uphold the right, even though shareholder value maximization would be negated. Section 36(1) provides that The rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors...The Constitution continues to state in s 39(2) that when interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights. The Bill of Rights, however, does not deny the existence of any other rights or freedoms that are recognised or conferred by common law, customary law or legislation, to the extent that they are consistent with the Bill (s39 (3)). A balancing process would have to be undertaken.

⁵³ In terms of section 36 of the Constitution, human rights (which include stakeholder rights) may be limited if the requirements stated therein are satisfied. If the requirements are not satisfied rights cannot be limited, as such a stakeholder right in such situation will be independently upheld irrespective of the fact that there may be contrary shareholder imperatives.

⁵⁴ See, for example, section 189 of the Labour Relations Act 66 of 1995.

⁵⁵ See in this regard paras 2.35-2.36 of Company formation and capital maintenance: a consultation document from the Company Law Review Steering Group. [Dti], UK October 1999.

⁵⁶ In the case of *Trevor v Whitworth*, ((1887) 12 App Cas 409 at 416), Lord Herschelle said: 'The company had purchased, prior to the date of the liquidation, no less than 4142 of its own shares; that is to say, considerably more than a fourth of the paid-up capital of the company had been either paid, or contracted to be paid, to shareholders, in consideration only of their ceasing to be so. I am quite unable to see how this expenditure was incurred in respect of or as incidental to any of the objects specified in the memorandum. And, if not, I have a difficulty in seeing how it can be justified. If the claim under consideration can be supported, the result would seem to be this, that the whole of the shareholders, with the exception of those holding seven individual shares, might now be claiming payment of the sums paid upon their shares as against the creditors, who had a right to look to the moneys subscribed as the source out of which the company's liabilities to them were to be met.' Lord Watson said the following (at 423-4): 'Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business.'

⁵⁷ This idea has always been questionable in that it is not realistic in the context of South African company law where no minimum share capital is prescribed and where companies are often incorporated with a share capital, which is completely inadequate for, their business needs.

CONFIDENTIAL

⁵⁸ See §6.40 (c) of the Model Business Corporation Act, Official Text with official comment and statutory cross-references revised through 2002.

⁵⁹ T Mongalo *Corporate Law & Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 158

⁶⁰ *Ibid* 158 – 59.

⁶¹ One of the earliest cases referred to in this area is that of *Keech v Sandford* (1726) Sel Cas Ch 61; 2 Eq Cas Abr; 25 ER 223.

⁶² See, among others, Mongalo (above) 160.

⁶³ As to what constitutes 'the interests of the company' for the purposes of directors' duties is discussed in chapter 3 above.

⁶⁴ 'In the mid-1980s, as a result of the severely constricted market for directors and officers liability insurance and a decision of the Supreme Court of Delaware in *Smith v. Van Gorkom*, 488 A.2d 858 (1985), holding directors of a corporation personally liable for money damages for failure to comply with their duty of care, many directors of U.S. corporations resigned or refused to stand for reelection. As a result, most of the U.S. states adopted statutes authorizing the charter to include a provision exculpating directors (and in some cases officers) from liability for money damages. See Model Act § 2.02(b)(4); Delaware General Corporation Law § 102(b)(7). Typically, these statutes, which may have had their origin in *In re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch. 425, apply only to suits by the corporation – directly or derivatively – and suits by shareholders, not to suits by creditors, employees or other third parties; only to suits for money damages, not for equitable relief; and only to suits under state law, not the federal securities or other federal laws. Moreover, these statutes do not permit exculpation for certain egregious misconduct, e.g., bad faith or willful misconduct.

Today, the overwhelming majority of publicly held corporations in the U.S. have director exculpation provisions in their charters. Because these provisions must be included in the charter, stockholder approval is required for existing corporations. These provisions, according to ABA, have worked well to encourage well-qualified individuals to serve on boards and to provide valuable protection to directors in the exercise of their duties. The ABA believes that shareholders should be able to decide for themselves – by inclusion of a provision in the charter – whether to forego a claim against directors for failure to perform their duties so long as that exculpation does not extend to egregious misconduct.' See the Report on South African Companies Act No. 61 of 1973 and Related Legislation by the American Bar Association Section of Business Law Committee on Corporate Laws (2001), 21 – 22.

⁶⁵ See Reform of the Canada Business Corporations Act: http://strategis.ic.gc.ca/epic/internet/incilp-pdci.nsf/vwGeneratedInterE/h_c100389e.html

⁶⁶ Rajak and Henning, 'Business Rescue for South Africa' 1999 (116) SALJ 262, at 286.